Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 22.28

Updated Mar 08, 2023

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

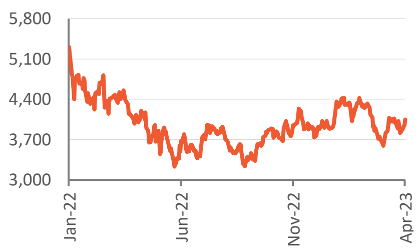
Company details

Market cap:	Rs. 24,746 cr
52-week high/low:	Rs. 4,512.70 / 3,210
NSE volume: (No of shares)	4.05 lakh
BSE code:	532541
NSE code:	COFORGE
Free float: (No of shares)	3.7 cr

Shareholding (%)

Promoters	30
FII	25
DII	32
Others	12

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.7	-5.6	8.5	-1.2
Relative to Sensex	7.4	-7.9	7.4	-6.7

Sharekhan Research, Bloomberg

Coforge Ltd

Good Q4, Decent guidance

IT & ITeS	Sharekhan code: COFORGE

Reco/View: Buy	↔	CMP: Rs. 4,050	Price Target: Rs. 4,900	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Coforge reported resilient Q4FY23 performance with beat in CC revenue growth at 4.7% q-o-q (versus estimate of 3.5%) led by broad-based growth across verticals, while EBITDA margin of 18.8% missed our estimate due to hedging losses offsetting currency tailwinds and an improvement in utilisation. PAT (adjusted for one-offs) was at Rs. 233 crore (up 2% q-o-q).
- Coforge achieved a $1-bn revenue milestone in FY23 and aims for $2-bn in the coming years. FY24 CC revenue guidance of 13-16% (management confident to achieve guidance and has surpassed its FY23 CC revenue growth guidance); expects to maintain margins at FY23 levels.
- Q4FY23 order intake was impressive at $301 million and total executable order book was up 20% y-o-y to $869 million. The management is focused on making investment in capabilities as well as sales & marketing with a target to achieve higher value deal wins.
- We maintain a Buy on Coforge with an unchanged PT of Rs4900 as consistent deal wins and healthy order intake provides good revenue visibility and thus makes valuation of 21x FY25E EPS reasonable versus mid-tier IT companies.

Coforge reported revenue of $264.4million with constant currency (CC) revenue growth of 4.7% q-o-q beating our estimates of 3.5% cc revenue growth. Revenue in rupee terms stood at Rs 2170 crore up 5.6% q-o-q/24.5% y-o-y in-line with our estimates of Rs 2,170.9 crore. EBITDA margins improved sequentially to 18.8% but was below our estimates of 19.4% on account of hedging losses offset by currency tailwinds and and improvement in utilisation. The company reported PAT at Rs 1,14.8 crore due to exceptional and one-time expenses which included provision of Rs 52.3 crore towards expenses incurred on ADR process and amount of Rs 80.3 crore towards gift to all the employees to commemorate achievement of $1 billion revenue milestone. Coforge reported robust order intake of $301 million in Q4FY23 vs $345 million in Q3FY23. It signed 2 large deals during the quarter one each in BFS and Travel verticals. Orderbook executable over next 12months stood at $869 million, up 20.7% y-o-y. Ten new logos were added during the quarter. LTM Attrition fell 170bps q-o-q to 14.1% Q4FY23. Net additions stood at 719 employees, taking the total headcount to 23,224. For the year BFS grew 47%, travel grew 21.5%, insurance declined 3.7%, and the other segment grew 23.1% in CC terms. For FY24, the company has provided revenue growth guidance of 13-16% growth in constant currency terms. On the profitability front, they expect the gross margin to increase by about 50 bps in FY24 over FY23 and adjusted EBITDA margins is expected to remain at similar levels as FY23. The management believes that growth across all the three core verticals will be in line and centered around the growth guidance number. Insurance segment would report growth indicatively around 15% for the year. We maintain a Buy on Coforge with an unchanged PT of Rs. 4,900 as consistent deal wins and healthy order intake provides good revenue visibility and thus makes valuation of 21x FY25E EPS reasonable versus mid-tier IT companies.

Key positives

- Order intake at US$301 million, fifth consecutive quarter of $300+ million order intake.
- Net additions stood at 719 employees taking the total headcount to 23,224
- Utilisation rate including trained employees improved by 120 bps to 81.5% from 80.3%. in Q3FY23
- LTM attrition rate declined 170 bps q-o-q to 14.1% in Q4FY23.

Key negatives

- Product Engineering vertical declined by 4.5%/4.3 on q-o-q and y-o-y basis respectively.

Management Commentary

- Management stated that they expect the growth in FY24 in BFS vertical compared to FY23 to be significantly lower. Management highlighted that macro headwinds in BFS are real and significant. So, they expect growth in BFS will moderate significantly from about 47% to 15%.
- Management expects core verticals and service lines to show broad-based growth. They expect growth across geographies to be broad based. The client cohorts top 5,top 10, top 20, top 50, should all be resilient and should be more or less in line with the guidance provided. The management cited that their exposure to client-specific regional banks is minimal. The only material exposure that they have is to Fifth Third Bank.

Revision in estimates – We have fine-tuned earnings estimates for FY24/FY25 owing to macro-overhang.

Our Call

Valuation – Good Q4, Maintain Buy: We believe Coforge's resilient performance and consistent deal wins would support growth in FY24. We expect a strong 13%/20% Sales and PAT CAGR respectively over FY23-25E. We maintain a Buy on Coforge with an unchanged PT of Rs4900 as consistent deal wins and healthy order intake provides good revenue visibility and thus makes valuation of 21x FY25E EPS reasonable versus mid-tier IT companies.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and possible recession in the US that may moderate the pace of technology spends.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	6432	8,014.6	9,137.4	10,342.0
OPM (%)	17.3	17.5	17.6	18.1
Adjusted PAT	661.7	811.7	986.6	1,180.7
% YoY growth	39.7	22.7	21.5	19.7
Adjusted EPS (Rs.)	109.0	133.6	162.2	193.8
P/E (x)	37.2	30.3	25.0	20.9
P/B (x)	9.0	8.0	6.7	5.5
EV/EBIDTA (x)	22.1	17.5	15.0	12.4
RoNW (%)	25.5	27.9	29.2	29.1
RoCE (%)	27.3	29.3	30.7	31.7

Source: Company; Sharekhan estimates

Stock Update

Result Update

Key highlights

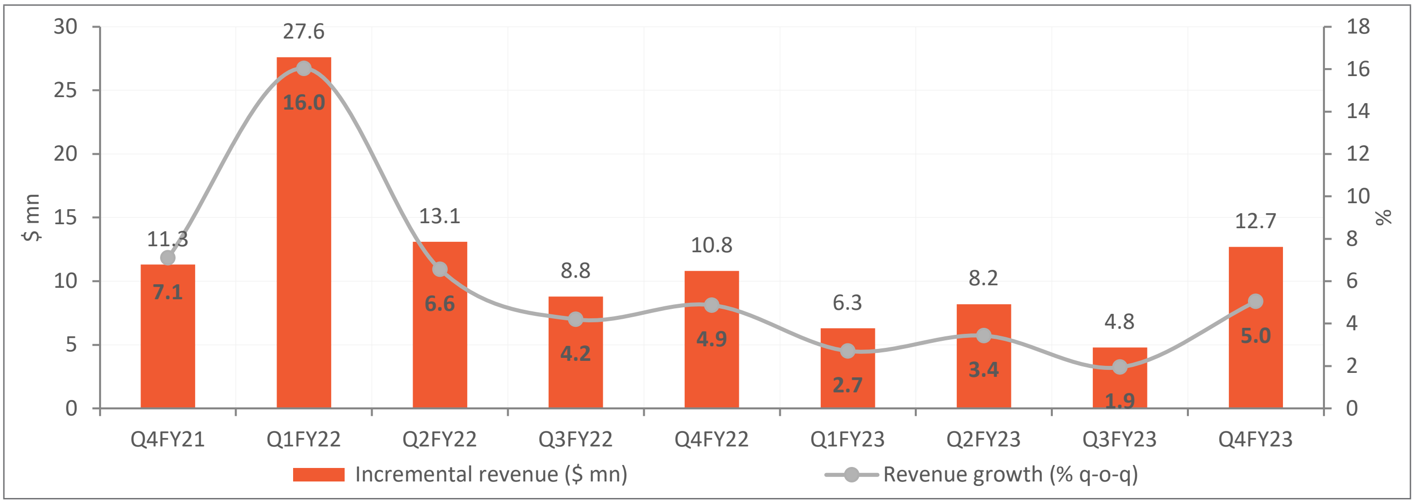
- **Revenue growth across verticals:** The BFS vertical grew 4.5% quarter-on-quarter in CC terms, the insurance vertical grew 5% quarter-on-quarter in cc terms, the travel vertical grew 2.54% quarter-on-quarter in CC terms, and the other verticals together grew 6.4% quarter-on-quarter in CC terms. For the year, the BFS vertical grew by 47%, travel grew 21.5%, insurance declined 3.7%, and the other segment grew 23.1% in CC terms.
- **Performance across geographies:** EMEA grew by 14.3% y-o-y and Americas grew by 9.4% y-o-y. RoW grew by 32.5% y-o-y after declining in Q3FY23.
- **Guidance for FY24:** For FY24, the company has provided revenue growth guidance of 13-16% growth in CC terms. On the profitability front, they expect the gross margin to increase by about 50 bps in FY24 over FY23 and adjusted EBITDA margin is expected to remain at similar levels as FY23.
- **Positive outlook across verticals:** The management believes all the three core verticals will more or less be in line, centered around that growth guidance number and deliver growth numbers that will be roughly similar. Insurance to report growth indicatively around 15% for the year.
- **Strong deal wins and robust deal pipeline:** Coforge reported robust order intake of $301 million in Q4FY23 versus $345 million in Q3FY23. It signed 2 large deals during the quarter, one each in BFS and Travel verticals. Order book executable over next 12months stood at $869 million, up 20.7% y-o-y. 10 new logos were added.
- **Muted growth in top accounts:** Top 5 clients grew by 1.1% and top 10 clients grew by 2.7% q-o-q to $60.8 million and $93.9 million, respectively. Coforge added 3, 4 and 1 clients on a y-o-y basis in the $10 million+ bucket, $5-10 million bucket and $1-5 million bucket, respectively.
- **Net headcount additions:** Net additions stood at 719 employees taking the total headcount to 23,224.
- **Improvement in utilisation rates:** Utilisation rate including trained employees improved by 120 bps to 81.5% from 80.3%. in Q3FY23
- **Attrition moderated:** LTM attrition rate declined 170 bps q-o-q to 14.1% which is one of the lowest in the industry.
- **Exceptional items:** Exceptional and one-time expenses include Provision of Rs 52.3 crore towards expenses incurred on ADR process and amount of Rs 80.3 crore towards gift to all the employees to commemorate achievement of $ 1 billion revenue milestone. Coforge will gift all its employees Apple iPads to celebrate the milestone of reaching over $1 billion in revenue.
- **ADR listing:** As market conditions continue to be unfavorable for the ADR issue and in line with business accounting prudence, a provision of Rs 52.3 crore for these expenses has been made in Q4FY23.
- **Healthy balance sheet metrics:** Cash & cash equivalents stood at Rs 602.5 crore as on March 31, 2023 vs Rs 471.8 crore as of March 31, 2022. DSO decreased by 12 days to 61 days from 73 days in Q3FY2023.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	Q3FY23	Y-o-Y %	Q-o-Q %
Revenues ($)	**264.4**	**232.4**	**251.7**	**13.8**	**5.0**
Revenues in INR	**2,170.0**	**1,742.9**	**2,055.8**	**24.5**	**5.6**
Direct expenses	1,430.6	1,162.0	1,369.8	23.1	4.4
Gross Profit	**739.4**	**580.9**	**686.0**	**27.3**	**7.8**
Selling / G&A	315.0	226.0	306.3	39.4	2.8
Acquisition related expenses & costs of ESOPs	16.8	25.6	18.2	-34.4	-7.7
EBITDA	**407.6**	**329.3**	**361.5**	**23.8**	**12.8**
Depreciation	71.7	58.4	62.4	22.8	14.9
EBIT	**335.9**	**270.9**	**299.1**	**24.0**	**12.3**
Other income	(48.7)	(11.9)	8.3	309.2	-686.7
PBT	**287.2**	**259.0**	**307.4**	**10.9**	**-6.6**
Tax provision	37.9	34.2	71.5	10.8	-47.0
Minority Interest	1.9	17.1	7.7	-88.9	-75.3
Net profit	**247.4**	**207.7**	**228.2**	**19.1**	**8.4**
EPS (Rs)	**38.2**	**34.1**	**37.4**	**12.0**	**2.1**
Margin (%)					
EBITDA	18.8	18.9	17.6	-11	120
EBIT	15.5	15.5	14.5	-6	93
NPM	11.4	11.9	11.1	-52	30
Effective Tax rate (%)	24.5	13.2	23.3	1,131	126

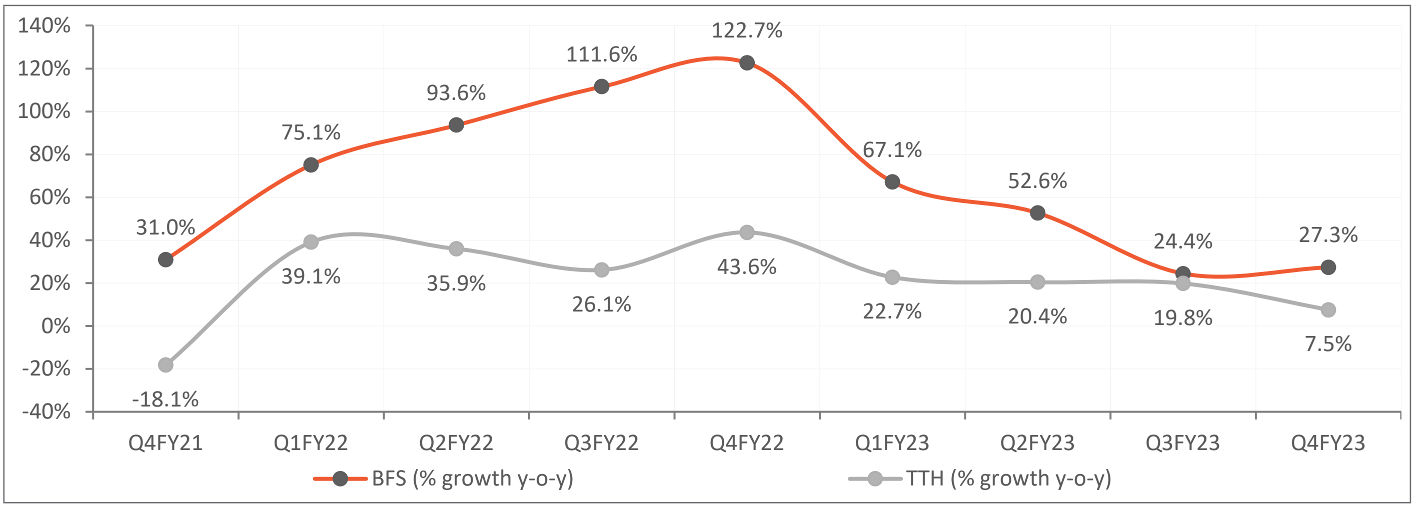
Source: Company; Sharekhan Research

Revenue growth trend



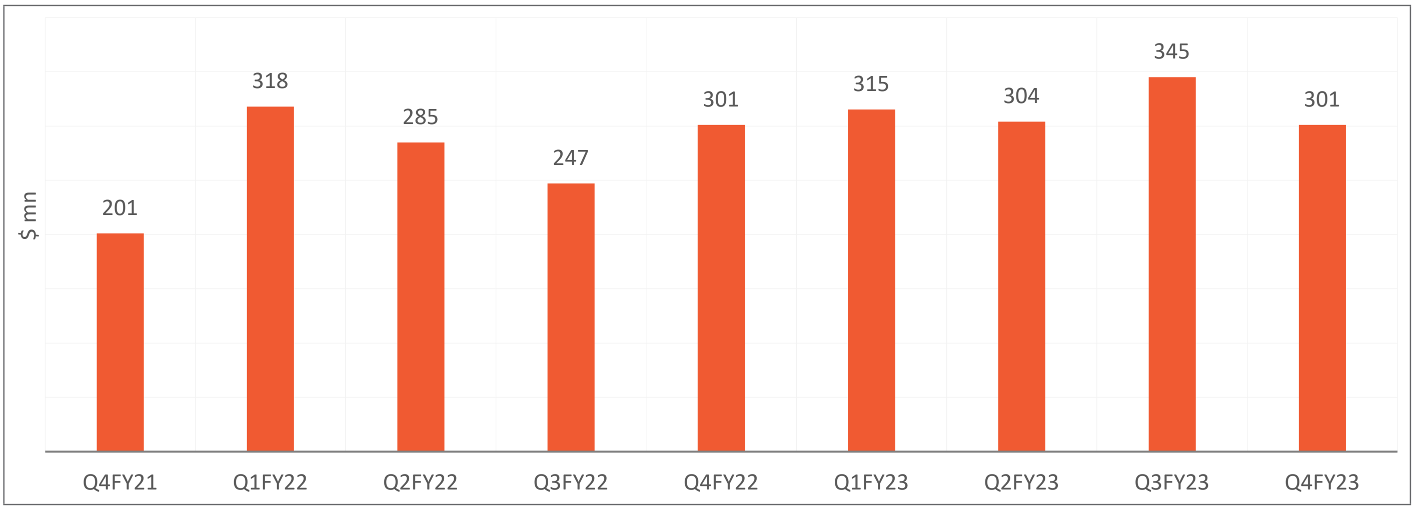
Source: Sharekhan Research

BFS growth (y-o-y) and TTH growth (y-o-y) trend



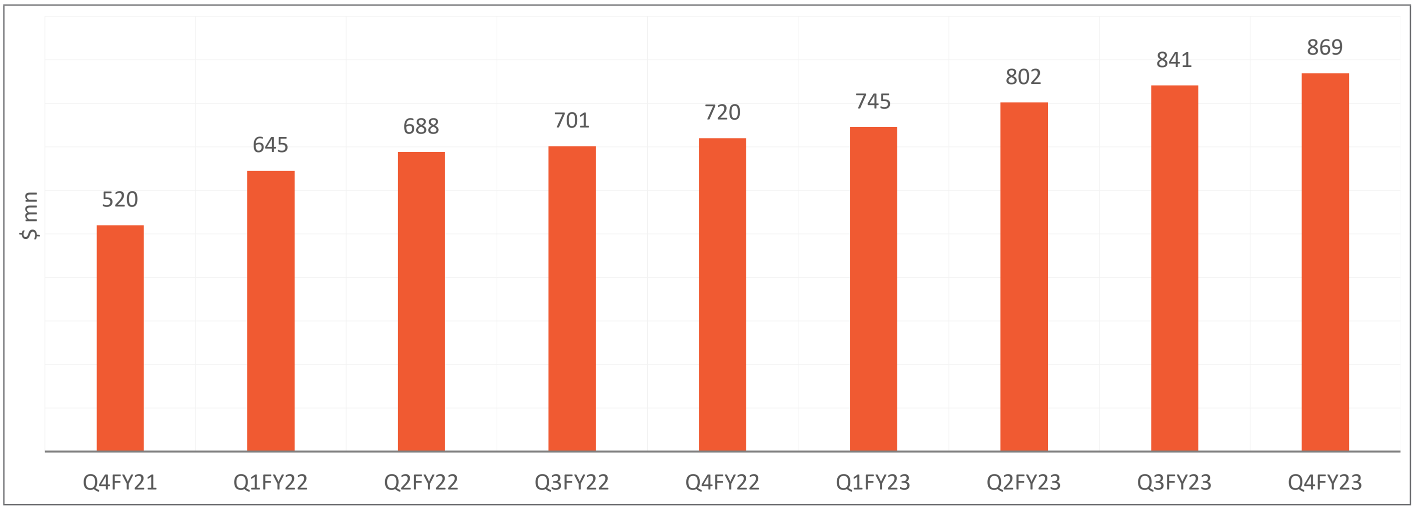
Source: Sharekhan Research

Fresh order book trend



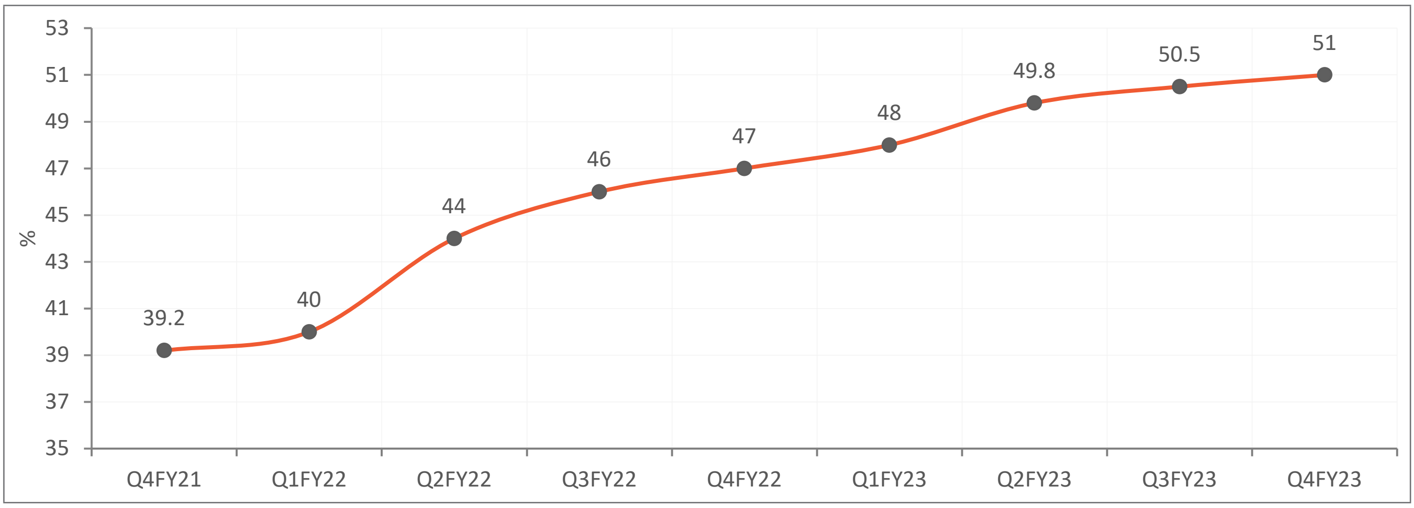
Source: Sharekhan Research

Executable orders to be executed over next 12 months



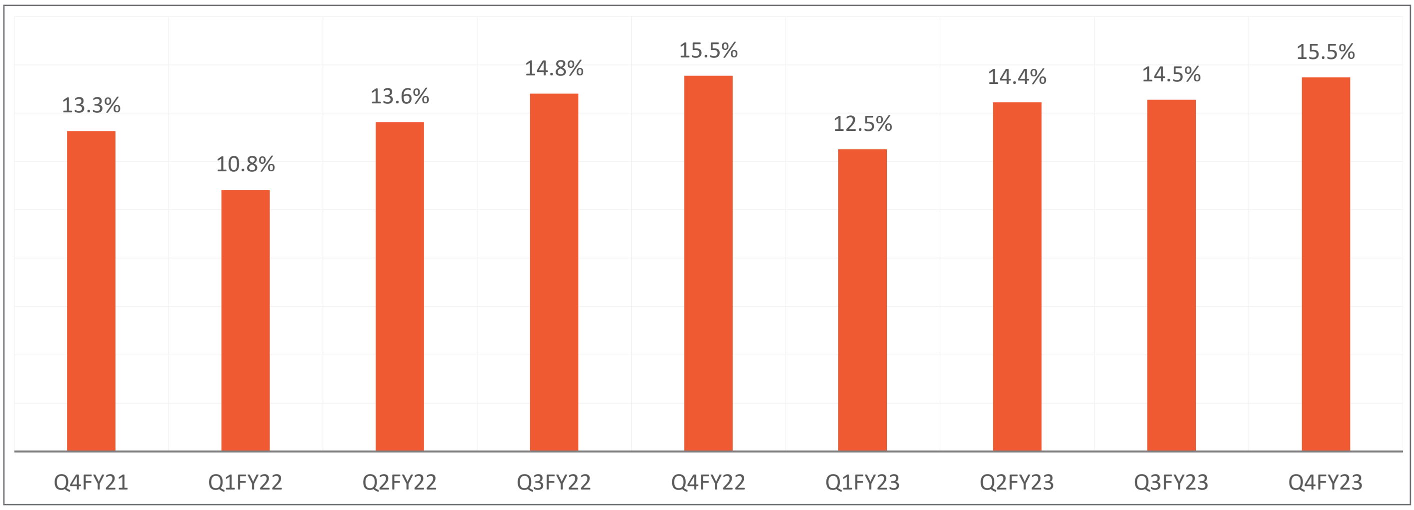
Source: Sharekhan Research

Offshore revenue mix (%) trend



Source: Sharekhan Research

EBIT margin trend



Source: Sharekhan Research

Outlook and Valuation

■ Sector View – Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

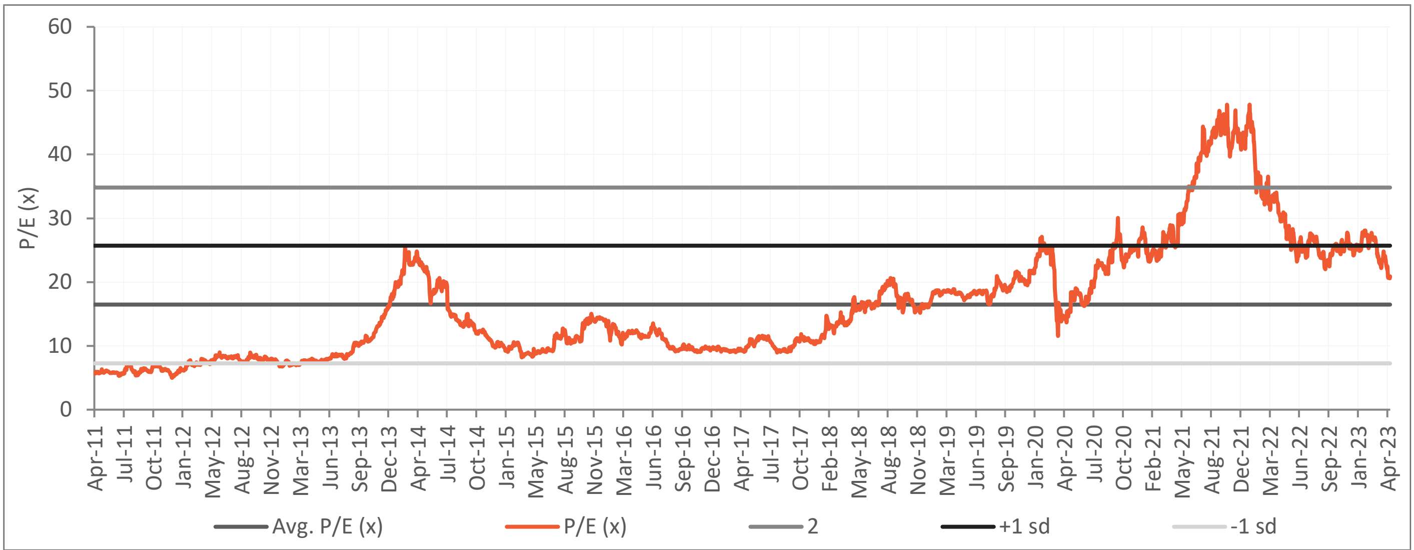
■ Company Outlook – Well-prepared for next leg of growth

Coforge has successfully transformed and re-organised itself into one of the fastest-growing mid-sized IT services provider under a revamped management in the past few years. Strong leadership, deep domain capability in select verticals, improved capability and marquee client base would help the company to sustain growth momentum. Further, strategic focus on diversifying the business into emerging verticals, improvement in client metrics, strong executable orders and sharp recovery in travel segment would further aid growth. Strong growth, better digital mix and operating efficiencies should drive margin expansion in the next two years.

■ Valuation – Good Q4, Maintain Buy

We believe Coforge's resilient performance and consistent deal wins would support growth in FY24. We expect a strong 13%/20% sales and PAT CAGR respectively over FY23-25E. We maintain Buy on Coforge with an unchanged PT of Rs4900 as consistent deal wins and healthy order intake provides good revenue visibility and thus makes valuation of 21x FY25E EPS reasonable versus mid-tier IT companies.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Established in 1981, Coforge is one of the leading mid-sized Indian IT services company, engaged in providing services in cloud, managed services, data & analytics, automation, application development & maintenance and Business Process Management. The company focuses on three key industries such as insurance, travel, transportation & hospitality and BFS. The company has started focusing on other industries such as manufacturing, healthcare, hi-tech, public sector to capture the opportunity. Digital technologies revenue, including product engineering, intelligent automation, data, integration and cloud, stood around 71% of total revenue. Coforge has over 22,000 professionals serving customers in North America, Europe, Asia and Australia.

Investment theme

Coforge's deep-domain expertise in select industry verticals and sub-verticals with heavy investments on technology, proprietary products and resources position it to participate in customers' transformation journey. Further, the company has reinvested its excess profitability in enhancing the technical capabilities by adding management/sales bandwidth. The company has also started scaling up the sub-segments such as healthcare within other verticals to drive its growth. We believe the company's differentiated positioning in select verticals, strong leadership, robust executable orders and mining of strategic accounts would position the company to deliver strong revenue growth going ahead.

Key Risks

- Rupee appreciation and/or adverse cross-currency movements
- Contagion effect of banking crisis, macro headwinds and possible recession in the US that may moderate the pace of technology spends.

Additional Data

Key management personnel

Sudhir Singh	Chief Executive Officer & ED
Ajay Kalra	Chief Financial Officer
Madan Mohan	EVP & Global Head - TTH
Gautam Samanta	EVP & Global Head - BFS
Rajeev Batra	EVP & Global Head - Insurance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co Ltd	6.5
2	Life Insurance Corp of India	4.79
3	Capital Group Cos Inc	4.3
4	UTI Asset Management Co Ltd	3.67
5	Aditya Birla Sun Life Asset Manage	3.46
6	HDFC Asset Management Co Ltd	3.3
7	Vanguard Group Inc/The	2.51
8	SMALLCAP World Fund Inc	2.41
9	Goldman Sachs Group Inc	1.56
10	CARNE GLOBAL FUND MANAGERS IRE	1.49

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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